HOW TO TRADE LIKE W.D. GANN

By Timothy Walker

Ask the average trader what the name W.D. Gann suggests and you'd probably get an answer like 'Square of Nine' or 'Astrology', or a comment about forecasting. While there is no doubt that such things formed an important part of Gann's work, there is much more to his story than that.

Gann's career in Wall Street spanned over 50 years, from 1902 to 1955. He was an active trader during that entire period, which saw two World Wars and the Great Depression. He began his career trading for his own account, and then, after some years set up an advisory service. He published annual forecasts on the stock and commodity markets and consulted with clients on the management of their trading accounts.

In 1923 he published the first of 6 books and also began to teach his methods to private students. Over the rest of his life he wrote many courses, covering both stocks and commodities. The first thing he taught his students was not how to forecast, but how to trade.

The basic theme of trading as Gann wrote about it was to buy when the market was going up and sell when it was falling. He was not a buy and hold strategist. His own research indicated that market movements are governed by cycles, which enabled a trader to determine in advance when these changes in direction should occur. This would enable him or her to change from a long to a short position or vice versa as close to the turns as possible.

However, it took a lot of study and work to master his forecasting systems, and so for some years he devoted his energies to designing a mechanical system which he could teach to traders with little or no previous experience. In 1930 he published this mechanical system for the first time, calling it the ***Method for Trading the Overnight Chart.***

The rules of the trading system itself were fairly straightforward, covering 4 pages and consisting of 9 rules and an explanation of how to draw a swing chart. But he then went on to illustrate the system by applying it to US Steel, at the time the largest stock on the board. He covered over 300 trades spanning a period of more than 16 years.

At that time, it was not practicable to sell a course accompanied by daily charts covering such a long period, and so all the explanation had to be given in the text. This makes for pretty dry reading, to put it mildly. But it occurred to me that he must have had a reason for going over so many trades, and so I decided to search for the price data to construct the charts.

This was easier said than done. The archivist at the NYSE replied that they didn't have data back that far. The US Steel Corporation itself, which is still listed, had data from 1950 onwards, which they happily shared. But this wasn't a help, because Gann's lesson covered the period from 1915 to 1931. Eventually the only solution was to go to the library and look up old newspapers and copy the data out one day at a time.

This was a time-consuming process, but what a gold mine of information this research revealed! Reading the text along with a chart started to reveal things about how Gann himself must have interpreted charts and therefore traded. Consider the following example. First the text:

'May 3rd advanced to 60¾, the third top around same level, where we should either sell out and go short with stop at 63¾ or leave stop at 57½ [under the last swing bottom]. We sold on stop at 57½.

'Decline followed, broke three bottoms made April 24, 27 and 30. We sell 200 shares more at 54¼. Decline continued to 48¼ where there were three bottoms, March 26, 31 and April 1st. Rule says, buy the fourth time with one point stop. We covered 300 shares short at 48½ and bought 200 at 48½ with stop at 46¾, which was one point under bottom of March 26th and April 1st.'

After several pages of this I start to go cross-eyed!

What he says is straightforward enough. The market had been going up for some time and made a triple top – either go short or wait for the last swing bottom to be broken. When it broke more support, add to the trade. Then, when it found support at the level of old lows, cover shorts and go long again.

But there was more to this trade than meets the eye, which only the price chart could reveal. See Chart 1.

The Buy and Sell arrows are located pretty accurately for the prices where the trades are indicated. If you look carefully at the bar for 10 May, you can see that the market made a very wide range that day. It opened at 53½

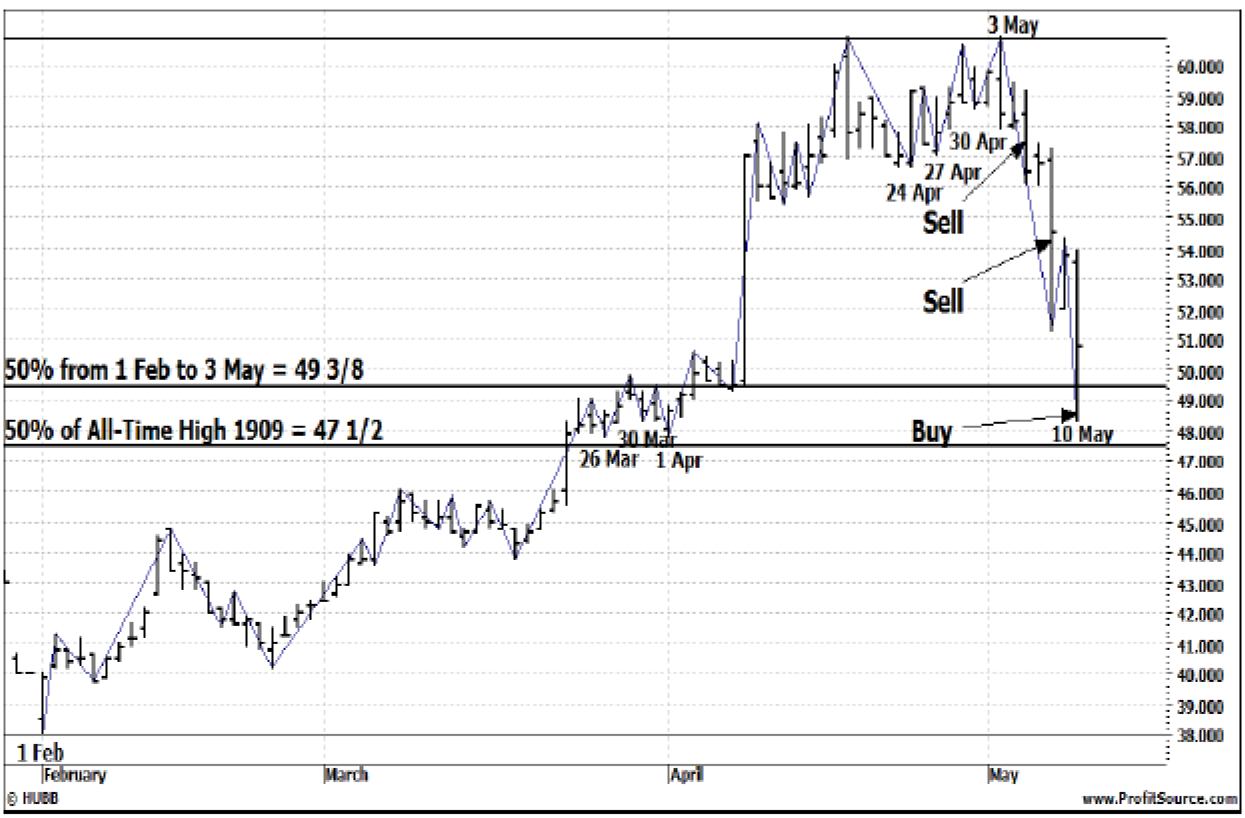

Chart 1

(prices in those days were quoted in 1/8 of a dollar) and then collapsed to 48¼, finally rallying to close at 50¾.

This example reveals a lot about Gann's thinking as a trader. When the market is falling heavily and everyone is panicking, he is telling us to look for a buying opportunity. As soon as the market enters a zone of support he is ready to cover shorts and go long. He acts 2 ticks off the intra-day low. I'm not sure how many of his beginner students would have felt comfortable trading this way!

Having an opportunity to see the actual chart, shows us that there was more to Gann's consideration in this trade than the simple rule of seeking support off the most recent bottoms. The chart includes two key 50% support levels which Gann does not mention in the text, but he would clearly have expected his students to be aware of, one from the current campaign and the other from the all-time high. He makes extensive use of 50% levels in the lesson, as he stated that you could make a fortune in the markets using just that one rule alone.

This example also reveals that he was teaching his students to follow the market during the trading session. This is something that he would change his mind on later in his career, but there are numerous examples of him acting intra-day in this lesson. Gann himself was an expert tape reader and traded on the floor of the Chicago Board of Trade, so these insights help us understand some of the techniques he would have used.

There are many little gems like this one scattered throughout the lesson, and I found so many of them that I decided to write the lesson up as a book and include charts of every trade. This way anyone could follow the rules

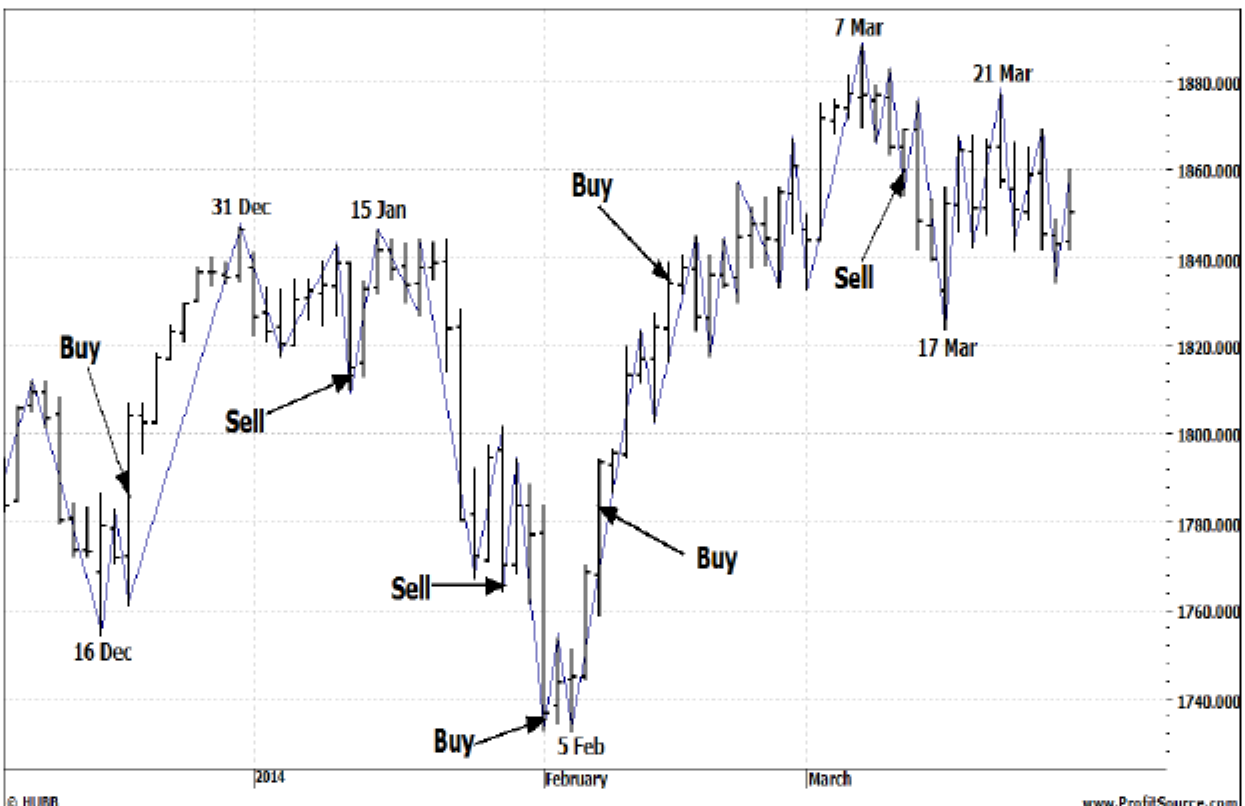

Chart 2

and strategy that Gann presented and gain a deeper insight into his thinking and trading methodology.

As an example of how his method would apply today, let us consider a chart of the e-mini S&P 500 futures contract. See Chart 2

Gann wrote his lesson for stocks trading around 50-200, so we have to make some assumptions to adjust for a stock index trading at 1800. You would have to test these to work out the optimum numbers, but for this exercise, I am going to place stops 5 points above swing tops or below swing bottoms. Gann's pyramiding rule was to add half the position size every so many points. I will use 50 points here. We will take an initial trade size of 2 contracts, based on Gann's risk management rules of only risking 10% of one's capital on any one trade, which would require a capital of $50,000.

We will assume that we have been trading the S&P for some time and simply pick up the trades from the beginning of 2014. As the New Year dawned, we would be long at around 1788 from 18 December. This trade was stopped out around 1812 on 13 January. Profit 24 points x 2 contracts = 48 points. As the system requires us to reverse positions we will be short 2 contracts at 1812 with the new stop placed above the 31 December high.

The market continued sideways for several days more. Gann was careful in such situations not to bring stops too close, so he would have left them above the 31 December high. An additional contract was sold at 1762 on 29 January.

On 3 February a special rule was triggered. Gann didn't even mention this rule at the beginning of his lesson and it is only in the trade examples that it becomes apparent. We would exit all short contracts at 1736 (total profit 178 points) and go long 2 contracts at that price.

Although the market went a fraction lower on 5 February, Gann's rule for stops would have kept the long trade intact, and we are placed to take the full benefit of the strong rally that followed. An extra contract is bought at 1786 and another again at 1836. All 4 contracts were stopped out at 1860 on 12 March. Total profit 346 points.

Total profit on 3 trades is 572 points or $28,600. Thus the return on our $50,000 capital over the first 3 months of the year, without deductions for commissions, was 57%. But don't forget that we are only trading with 10% of our capital in this example, so the returns on the actual "at risk" investment are much higher. If we consider that our initial investment was approximately $5,000, and we generated a $28,000 return, we actually produced 570% on our initial investment in only 3 months! Not bad for a relatively simple mechanical system...

Currently we would be short 2 contracts at 1860. Again being careful not to move stops too close in a see-sawing market, the initial stop above the 7 March high would now be moved down above the two swing tops on the 13th and 21st.

This, of course, is a paper-trading example only, but it serves to illustrate that the rules Gann wrote almost 90 years ago can still be applied profitably by a trader in the 21st Century.

[*How to Trade Like WD Gann* is published by the Sacred Science Institute, www.sacredscience.com/Walker/HowToTradeLikeWDGann.htm]